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Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-653

ASARCO Incorporated (formerly
The American Smelting and Refining Company),
Appellant,

v.

MONTANA DEPARTMENT OF REVENUE
OF THE STATE OF MONTANA,
Appellee.

On Appeal from the
Supreme Court of Montana

BRIEF OF THE MULTISTATE TAX COMMISSION AS AMICUS CURIAE IN SUPPORT OF APPELLEE'S MOTION TO DISMISS

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BRIEF OF THE MULTISTATE TAX COMMISSION AS AMICUS CURIAE IN SUPPORT OF APPELLEE'S MOTION TO DISMISS

I.
INTRODUCTORY STATEMENT

This brief is submitted by the Multistate Tax Commission (hereinafter referred to as the Commission) as

amicus curiae in support of Appellee's Motion to Dismiss. Both parties to this proceeding have consented to the filing of this brief.[1]

II.

STATEMENT OF INTEREST

The Commission is the official administrative agency of the Multistate Tax Compact (hereinafter referred to as the Compact) entered into currently by 19 states as full members, and by 13 states as associate members.[2]

The purposes of the Compact are to:

1. Facilitate proper determination of state and local tax liability of multistate taxpayers, including the equitable apportionment of tax bases and settlement of apportionment disputes.

2. Promote uniformity or compatibility in significant components of tax systems.

3. Facilitate taxpayer convenience and compliance in the filing of tax returns and in other phases of tax administration.

4. Avoid duplicate taxation.

In fulfillment of these objectives in the area of state income taxation of multistate businesses, Article IV of

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[1]See Exhibit A, pages 1a-2a of the Brief of the Committee on State Taxation of the Council of State Chambers as Amicus Curiae in Support of Appellant's Jurisdictional Statement.

[2]The current regular members are the states of Alaska, Arkansas, California, Colorado, Hawaii, Idaho, Kansas, Michigan, Missouri, Montana, Nebraska, New Mexico, Nevada, North Dakota, Oregon, South Dakota, Texas, Utah and Washington.

The current associate members are the states of Alabama, Arizona, Georgia, Louisiana, Maryland, Massachusetts, Minnesota, New Jersey, Ohio, Oklahoma, Pennsylvania, Tennessee and West Virginia.

the Compact sets forth the provisions of the Uniform Division of Income for Tax Purposes Act (UDITPA) promulgated by the National Conference of Commissioners on Uniform State Laws in 1957.[3] UDITPA apportions "business income" in accordance with the well recognized three factor apportionment formula of property, payroll, and sales, commented on by this Court in *General Motors Corp. v. District of Columbia*, 380 U.S. 553 (1965).

Article VII of the Compact permits the Commission to promulgate advisory rules and regulations concerning this Uniform Act. The Compact (Article VIII) also provides for joint audits at the request of member states to further implement uniform enforcement of the Uniform Act. In this manner, the Compact and the Commission have sought to substantially diminish potential problems of overtaxation or undertaxation of the income of enterprises carrying on business activities in two or more states or countries. The Commission is thus concerned with the effort of Appellant and C.O.S.T. to seek review in this Court of the Supreme Court of Montana's interpretation and application of the language of UDITPA which involves only a question of state law.[4]

The Commission is also concerned with Appellant's and C.O.S.T.'s position that the corporate form rather than business and economic substance control the constitutionality of state income tax laws; for that is all their position consists of when they argue that the uni-

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[3]Uniform Laws Annotated, Vol. 9a, p. 448 et seq.

[4]While Montana had not enacted the language of UDITPA in statutory form for the years in question, the Montana Supreme Court upheld the Appellee's regulations adopting the language of UDITPA as a reasonable implementation of Section 84-1503, R.C.M. 1947.

tary concept, as applied to a group of affiliated corporations ("combined reporting"), is unconstitutional.

The Commission is further concerned with Appellant's and C.O.S.T.'s unwarranted attacks on the Compact, the Commission and Montana's administration of its tax laws. These are political attacks based on statements of C.O.S.T.'s and Appellant's own self-serving choosing, which are completely unsupported. These attacks have nothing to do with this appeal.

III.

THE ARGUMENT

A. *INTRODUCTORY CONSIDERATIONS AND SUMMARY OF ARGUMENT.*

This is an appeal from the Montana Supreme Court. It is therefore important to note what was before the Supreme Court of Montana for resolution. The basic issue before the Montana Supreme Court was whether or not a "hybrid" method used by the Appellant to determine its Montana taxable income for the years in question constituted a correct interpretation of Section 84-1503, R.C.M. 1947. In reporting its income tax liability to Montana for the years in question, the Appellant first determined its total taxable income by deducting all of the expenses it deducted in arriving at federal taxable income. It then made certain state adjustments to federal taxable income and then deducted the gross amount of income derived from royalties, dividends, rentals, interest, and gains on the sale of stock from federal taxable income to arrive at apportionable income. For example, in regard to its rental properties, the Appellant deducted all of the rental expenses including taxes, depreciation and interest charges associated with its rental properties to arrive at federal taxable income and then

deducted for Montana income tax purposes the gross rental income. The Appellant then apportioned the net results of these adjustments and deductions by the three factor UDITPA formula to arrive at Montana taxable income. Appellant interpreted Section 84-1503, R.C.M. 1947 to permit this method of reporting. Appellant thus asserted that the Appellee had no authority under Section 84-1503, R.C.M. 1947 to require the Appellant to apportion all of its unitary income in accordance with the regulations of Appellee which adopted the unitary concept for the apportionment of income and employed the distinction between "business" and "nonbusiness" income as defined in Section 1(a) of UDITPA. Furthermore, the Appellant contended that the Appellee could not ascertain the Appellant's taxable income and the apportionment factors by the so-called "combined reporting" method.

The Montana Supreme Court, in answering these contentions of the Appellant, simply found that Section 84-1503, R.C.M. 1947 did not permit the Appellant to apportion a part of its income and "separately account" for part of its income. It further found that the Appellee had the authority to adopt regulations for the apportionment of the entire unitary income of the Appellant, including utilization of the "combined method" of reporting. Furthermore, in applying the UDITPA regulation language and the "combined reporting" method to Appellant, the Court determined as a matter of fact that (1) all of Appellant's income was income from its unitary business ("business" income); and (2) that Appellant was conducting a unitary business with six of its wholly owned subsidiaries.

In making its argument before the Supreme Court of Montana and other Montana tribunals, the Appellant did not argue that the UDITPA regulations of the Appel-

lee were unconstitutional in requiring the apportionment of "business" income. Furthermore, Appellant did not argue that "combined reporting" was unconstitutional. Rather, the Appellant argued that Appellee had no authority under Montana law to require full apportionment of business income and "combined reporting."

Appellant has sought to raise the constitutionality of the UDITPA distinction between business and nonbusiness income as applied by the Montana Supreme Court and the constitutionality of the "combined method" of reporting for the first time in the Montana Courts in its application for rehearing in the Montana Supreme Court.

Contrary to the argument of C.O.S.T. and Appellant, this appeal does not involve the validity of the Multistate Tax Compact which is before this Court for resolution in *United States Steel Corp., et al. v. Multistate Tax Commission et al.*, Docket No. 76-635, submitted October 11, 1977. Neither does it involve the validity of the Commission's joint audit program or its advisory regulations implementing the language of Article IV of the Compact (UDITPA). Thus, the only questions at issue which could possibly give rise to federal questions are the constitutionality of UDITPA as interpreted and applied by the Montana Supreme Court and the "combined report" method utilized by Appellee to compute Appellant's Montana tax liability. However, as indicated in Appellee's brief, these issues were not timely raised for consideration either by the Montana Supreme Court or this Court on appeal.

Inasmuch as decisions of this Court have all upheld the apportionment of the unitary income of a trade or business by the well recognized three factor formula contained in UDITPA, Appellant has not otherwise raised a substantial federal question.

B. CONTRARY TO APPELLANT'S AND C.O.S.T.'S ARGUMENT, THE UNIFORM DIVISION OF INCOME FOR TAX PURPOSES ACT WHICH REQUIRES THE APPORTIONMENT OF ALL BUSINESS (UNITARY INCOME) OF A MULTISTATE TAXPAYER IS CONSTITUTIONAL AND VALID IN EVERY RESPECT.

It is well settled that the states may apportion the unitary income of a unitary business by application of the generally recognized three factor apportionment formula [*General Motors Corp. v. District of Columbia, supra*, 380 U.S. 553 (1965); *Butler Bros. v. McColgan*, 315 U.S. 501 (1942)]. It is equally well settled (1) that one who attacks a formula of apportionment carries a distinct burden of showing by "clear and cogent evidence" that it results in extraterritorial values being taxed *(Butler Bros. v. McColgan, supra)*; and (2) that an apportionment formula that arrives at a rough approximation of income attributable to a particular state is constitutional (*International Harvester v. Evatt*, 329 U.S. 416, 422 (1947).

There is no question but what Appellant was conducting a unitary business in Montana and that its income was subject to apportionment. As specifically noted by the Montana Supreme Court:

> "In 1962, ASARCO recognized that its business was unitary in nature and that it could no longer use separate accounting for its income. Pursuant to Section 84-1503 it requested permission from DOR [Department of Revenue of the State of Montana] to change from separate accounting to the unitary method of accounting. Permission was granted by DOR and a 'hybrid' system of reporting income was instituted. Under this hybrid system, all but a negligible amount of total company income from

rents, royalties, dividends, interest and sales of tangible and intangible properties was allocated to sources outside of Montana. After deductions for the allocated income, ASARCO's operating net income was apportioned to Montana sources by the use of a three factor formula." (Material in brackets added Appellant's Appendix p. 3a)

The constitutional question then is whether or not the Appellant can apportion a part of its unitary income and segregate the balance of its unitary income by "sources" (either by situs or corporate entity) and separately account for that balance.[5] This is indeed a novel method of attribution of income for state income tax purposes. It has never been supported in any manner by any decision of this Court.

The Montana regulations which adopt the language of UDITPA provide for the specific allocation of "nonbusiness" income and the apportionment of "business" income under the three factor UDITPA formula. Business income is there defined in Section 1002(a) as "income from any transactions and activity in the regular course of the taxpayer's trade or business and includes income

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[5]As indicated on ASARCO's income tax returns to Montana for the years in question, the following constitutes its federal taxable income, its allocated nonbusiness income and income subject to apportionment:

Year	*Federal Taxable Income*	*Allocable Nonbusiness Income*	*Apportionable Income*
1967	60,572,768	45,169,221	15,358,547
1968	62,531,929	62,548,620	(16,291)
1969	92,480,382	76,869,974	15,610,408
1970	115,219,427	115,584,872	(365,445)

(Figures in parenthesis are negative figures.)

Except for a neglible amount, all the nonbusiness income was purported allocated to states other than Montana.

from tangible and intangible property if the acquisition, management and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations." The Commission regulations, which are criticized by C.O.S.T., are contained in the Commission Reg. IV.1.(a)[6] which reads in pertinent part:

> "Income of any type or class or from any source is business income if it arises from transactions and activities occurring in the regular course of a trade or business. Accordingly, the critical element in determining whether income is 'business income' or 'nonbusiness income' is the identification of the transactions and activity which are the elements of a particular trade or business. In general, all transactions and activities of the taxpayer which are dependent upon or contribute to the operations of the taxpayer's economic enterprise as a whole constitute the taxpayer's trade or business and will be transactions and activity arising in the regular course of, and will constitute integral parts of, the trade or business."[7]

Notwithstanding the issue as framed by the Montana Supreme Court, as we understand Appellant's and C.O.S.T.'s argument, it is their contention that UDITPA is unconstitutional to the extent it requires apportionment of "business" income which is not derived from so-called trading profits and which can be "sourced" by property tax situs concepts. As will be demonstrated

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[6]Seventh Annual Report of the Commission, June 30, 1974, p. 64.

[7]While the advisory regulations of the Commission interpreting this language which is contained in Article IV of the Compact was not considered by the Montana Supreme Court and not adopted by Montana for the years in question, it is significant to note that those regulations are not at variance with the definition of "business" income as set forth in Section 1(a) of Article IV of the Compact and UDITPA.

herein, we do not believe this raises a substantial federal question.

Starting with the early utility property tax cases, this Court has uniformly upheld the apportionment of the entire properties or income attributable to a unitary business by an apportionment formula which has not been demonstrated by the taxpayer by clear and cogent evidence to tax extraterritorial income or values.

In *Adams Express Co. v. Ohio State Auditor*, 165 U.S. 194 (1896), this Court summarized the holdings of its prior utility property tax decisions pertaining to unitary reporting as follows:

> "As to railroad, telegraph and sleeping-car companies, engaged in interstate commerce, it has often been held by this Court that their property in the several states through which their lines or business extended might be valued as a unit for purposes of taxation, taking into consideration the uses to which it was put and all the elements making up aggregate value, and that a portion of the whole fairly and properly ascertained might be taxed by the particular state, without violating any federal restrictions. [Cases cited.] The valuation was, thus, not confined to the wires, poles, and instruments of the telegraph company; or the roadbed, ties, rails and spikes of the railroad company; or the cars of the sleeping-car company, but included the proportionate part of the value resulting from the combination of the means by which the business was carried on, a value existing to an appreciable extent throughout the entire domain of operation." (165 U.S. 220, 221)

In the *Adams Express Co.* case, this Court went on to hold that all of the property of the express company which was used in its trade or business, including its intangible assets, were properly subject to apportionment

for ad valorem property tax purposes. Furthermore, this Court there held that:

> "Presumptively, all the property of the corporation or company is held and used for the purposes of its business, and the value of its capital stock and bonds is the value of only that property so held and used." (165 U.S. 227)

This Court therefore concluded in the *Adams Express Co.* case that the total market value of the stock of the express company could be taken into consideration in valuing its properties within the taxing state, even though its intangibles had a specific situs outside the taxing state.

The foregoing conclusion of this Court in the *Adams Express Co.* case was vigorously opposed by the Company in a lengthy petition for hearing. The Court granted the rehearing and issued its opinion in accordance therewith in *Adams Express Co. v. Ohio State Auditor*, 166 U.S. 185 (1897). In the rehearing, the Express Company objected to including its intangible properties as part of the value subject to apportionment and taxed in part by the State. In holding that the intangible properties (which constituted three-fourths of the total value of the Express Company's capital stock) could be subject to taxation by the apportionment method, this Court reasoned as follows:

> "Where is the situs of this intangible property? Is it simply where its home office is, where is found the central directing thought which controls the workings of the great machine, or in the state which gave it its corporate franchise; or is that intangible property distributed wherever its tangible property is located and its work is done? Clearly, as we think, the latter. Every state within which it is transacting business and where it has its prop-

erty, more or less, may rightfully say that the $16,000,000 of value which is possesses springs not merely from the original grant of corporate power by the state which incorporated it, or from the mere ownership of the tangible property, but springs from the fact that the tangible property it has combined with contracts, franchises and privileges into a single unit of property, and this state contributes to that aggregate value not merely by the separate value of such tangible property as is within its limits, but its proportionate share of the value of the entire property.

"It may be true that the principal office of the corporation is in New York, and that for certain purposes the maxim of the common law was '*Mobilia personam sequuntur*,' but that maxim was never of universal application, and seldom interfered with the right of taxation. *Pullman's Palace Car Co. v. Pennsylvania*, 141 U.S. 18, 22. It would certainly seem a misapplication of the doctrine expressed in that maxim to hold that by merely transferring its principal office across the river to Jersey City, the situs of $12,000,000 of intangible property for purposes of taxation was changed from the state of New York to that of New Jersey." (166 U.S. 223-224)

It is thus clear that the *Adams Express Co.* cases and cases relied on therein clearly establish a unit rule or unitary concept for state tax purposes and permit a state to determine the instate privilege, property or income by reference to the total privileges, property or income of the multistate business if there is a unitary relationship between the instate activities or property of the business and its total activities or properties everywhere. They also establish the proposition that all of the properties or

income of a unitary business are subject to a reasonable rule of apportionment. These cases also support the principle that an apportionment formula is deemed to be reasonable in result and the burden is upon the taxpayer to establish otherwise.

In the income tax case of *Butler Bros. v. McColgan*, *supra*, this Court noted:

"At least since *Adams Express Co. v. Ohio*, 165 U.S. 194, this Court has recognized that unity of use and management of a business which is scattered through several states may be considered when a state attempts to impose a tax on an apportionment basis." (315 U.S. 508)

This Court therein upheld the validity of the three factor apportionment formula against the entire unitary income of Butler Bros. In the language of the Court:

"We cannot say that property, payroll, and sales are inappropriate ingredients of an apportionment formula. We agree with the Supreme Court of California that these factors may properly be deemed to reflect 'the relative contribution of the activities in the various states to the production of the *total unitary income*,' so as to allocate to California its just proportion of the profits earned by Appellant from this unitary business. And no showing has been made that income unconnected with the unitary business has been used in the formula." (Emphasis added) (315 U.S. 509)

It is thus submitted on the basis of authorities such as the *Adams Express Co.* cases and *Butler Bros. v. McColgan*, and cases of like import, that there is absolutely no merit to Appellant's and C.O.S.T.'s argument that only the state of commercial domicile has the constitutional right to include income from intangible properties in apportionable income. In fact, if intangible proper-

ties and income from such intangibles are used in connection with and are integral parts of a taxpayer's trade or business operations, it would appear that the commercial domicile has no valid constitutional basis for attributing the entire income from such properties to it. The commercial domicilary state certainly has no greater claim to tax such income than the legal domicile, the place where the intangibles are physically located, or states in which the intangibles have acquired "a business situs." In fact, the apportionment of unitary income from intangibles to where a unitary integrated business carries on its trade or business activities reflected by its property, payroll and sales is nothing more nor less than a modern application of the "business situs" concept.[8]

It is significant to note that *Wheeling Steel Corp. v. Fox*, 298 U.S. 193 (1936), cited on page 18 of C.O.S.T.'s brief, specifically noted that situs concepts utilized for property tax purposes were not controlling for attribution of income for income tax purposes. It there stated:

> "The tax is not on the net profits of a unitary enterprise demanding a method, not intrinsically arbitrary, of making an apportionment among different jurisdictions with respect to the processes by which the profits are earned. [Citations omitted] Such a tax on net gains is distinct from an ad valorem property tax on the various items of property

[8]In fact, it may be necessary, as found by the Supreme Court of Minnesota in *Marshall-Wells Co. v. Commission of Taxation*, 220 Minn. 458, 20 N.W.2d 92 (1945), that intangibles be utilized in the business operations of the taxpayer before the intangibles or income therefrom can be taxed at the commercial domicile. As noted by the Court in *Marshall-Wells Co.*, this certainly was found to be true in *Wheeling Steel Corporation v. Fox*, 298 U.S. 193 (1936).

> owned by the corporation and laid according to the location of the property within the respective tax jurisdiction . . ." (298 U.S. 212)

In determining the importance of investments to the overall business operations, this Court aptly noted in *Flint v. Stone Tracy Co.*, 220 U.S. 107 (1911):

> "Nor can it be justly said that investments have no real relationship to the business transacted by a corporation. The possession of large assets is a business advantage of great value; it may give credit which will result in more economical business methods; it may give a standing which shall facilitate purchases; it may enable the corporation to enlarge the field of its activities and in many ways give it business standing and prestige." (220 U.S. 166)

Ford Motor Co. v. Beauchamp, 308 U.S. 331 (1939), upheld the apportionment of an excess of $23,000,000 of the capital of Ford Motor Company to Texas when there was only approximately $3,000,000 of its assets physically located in Texas. Significantly, this Court stated:

> "In a unitary enterprise, property outside of the state necessarily affects the worth of the privilege within the state. Financial power inherent in possession of assets may be applied, with flexibility, at whatever point within or without the state the managers of the business may determine. For this reason, it is held that an entrance fee may be properly measured by capital wherever located. The weight, in determining the value of the intrastate privilege, given the property beyond the state's boundaries, is but a recognition of the very real effect its existence has upon the value of the privilege granted within the taxing state." (308 U.S. 336)

There is nothing in the record to indicate that the Appellant's so called investments and income derived therefrom were not utilized by Appellant in its overall business operations. The record establishes otherwise. Furthermore, Appellant does not contend that its investment properties and income derived therefrom were not part of its unitary operations (Juris. St., pp 12-16) and did not contribute to its overall operations including those conducted in Montana for the years in question. Furthermore, there is nothing in the record to indicate and Appellant does not argue that the three factor UDITPA apportionment formula arrives at an unreasonable result in apportioning a small part of its entire taxable income to Montana.

Contrary to C.O.S.T.'s argument (C.O.S.T.'s brief, page 18), and Appellant's argument (Juris. St., p. 12) no court has ever limited constitutional formulary apportionment to the *trading profits* or operating income of a business. In fact, the cases have universally held that the income of a unitary business which is connected with business activities carried on in part within a taxing state may be subject to formulary apportionment even though derived from intangible properties. In *International Harvester v. Department of Taxation*, 322 U.S. 435 (1944), and *Wisconsin v. J. C. Penney Co.*, 311 U.S. 435 (1940), this Court upheld the apportionment of income from dividends against the payor corporation based on its instate activities. In *Montgomery Ward & Co. v. Commissioner of Taxation*, 276 Minn. 479, 151 N.W. 2d 294 (1967), and *Great Lakes Pipeline Co. v. Commissioner of Taxation*, 272 Minn. 403, 138 N.W.2d 612 (1965), app. dism'd 384 U.S. 718 (1966), the Court held that interest income was business income subject to apportionment. In *F. W. Woolworth Co. v. Director of Division of Taxation*, 45 N.J. 466, 213 A.2d 1 (1965);

Gulf Oil Corp. v. Morrison, 120 Vt. 324, 141 A.2d 671 (1958); and *F. W. Woolworth Co. v. Commissioner of Taxes*, 130 Vt. 544, 298 A.2d 839 (1972), the Courts held that dividend income was subject to apportionment either as business income or as a part of the unitary income of the payee corporation. In *Sperry & Hutchinson Co. v. Department of Revenue*, 270 Or. 329, 527 P.2d 729 (1974), the Court held that interest income used in the trade or business of the taxpayer was subject to apportionment under UDITPA. As indicated in *Appeal of W. J. Voit Rubber Co., May 1947 C.C.H. Cal. Tax Rep. para. 202-435*, and cases cited therein, the California Board of Equalization has always held that income from a unitary business, whether from intangible properties or otherwise, is subject to formulary apportionment. *In Re Goodyear Tire & Rubber Co. Corporate Income Tax 1966, 1967, 1968*, 133 Vt. 132, 335 A.2d 310 (1975), the Court upheld the apportionment of dividend income.

The Minnesota Supreme Court in *Montgomery Ward & Co. v. Commissioner of Taxation, supra*, analyzed its holding in *Great Lakes Pipeline Co. v. Commissioner of Taxation, supra*, in part as follows:

> ". . . intangible property is employed in a business if the corporation owning the intangible property holds it as a means of furthering the business operation of which a part is located within the territorial confines of this state.
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> ". . . the evidence established that the intangibles held by Great Lakes Pipeline Co. were a part of one unitary business operation (i.e., the business of transporting refined petroleum products by pipeline) because (a) the business activities produced the income used to purchase the intangibles; (b) the in-

come from the intangibles was commingled with the business earnings of the corporation; the securities were at all times carried as current assets; and the same financial officers controlling the affairs of the Pipeline Company were responsible for the investments involved; (c) *the increase, gain, and principal of these intangibles was used entirely to pay various expenses and obligations of the business activities.*" (151 NW 2d 296)

In referring to the test to be utilized in determining whether income is utilized in the overall business operations, the court in *Montgomery Ward & Co. v. Commissioner of Taxation, supra*, stated:

"But where the fund so held is not set aside as a reserve for future expansion and made unavailable for current operating expense; where the management of the investment and reinvestment of corporate funds in the intangibles is entrusted to the corporate officers who manage the principal business; where the income from the intangibles is commingled with ordinary business income; and where the operating expenses of the business enterprise are paid generally from such commingled funds, the taxpayer's burden of establishing that the intangibles were not employed in the principal business would seem to be an extremely difficult one." (151 NW 2d 296-297)

Nor is there merit to C.O.S.T.'s argument that the inclusion of income from intangible properties in apportionable income results in taxation of more than 100% of income. There is absolutely no proof in this case nor assertion by the Appellant that any of the income apportioned to Montana has been specifically allocated to and taxed by any other state. To our knowledge no state specifically allocates the business income of a unitary business. Thus, C.O.S.T.'s multiple taxation argument is

pure conjecture not supported by any facts. This is not to suggest that the states have been consistent in the apportionment or specific allocation of items of income, including those from intangible properties. Because of the problems associated with differing practices of the states in allocating or apportioning various items of income, the Willis Subcommittee recommended full apportionment of all income.[9]

Furthermore, C.O.S.T.'s assertion that all income from intangible properties has traditionally been allocated to the commercial domicile for state income tax purposes (C.O.S.T.'s Brief pp. 12-13) is specifically refuted by the Willis Report. Volume 1 of that Report[10] deals with the problem of specific allocation of income and deductions therefrom by state practices at the time of the Report. The Report noted on page 198:

"On the basis of the methods which they used to determine what income is specifically allocable, the states may be divided into three groups: (a) those which rely solely on an itemization of the particular types of income to be specifically allocated; (b) those which distinguish between business income and nonbusiness income; and (c) those which distinguish between unitary business income and other income."

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[9]The Report of the Special Subcommittee on State Taxation of Interstate Commerce of the Committee on the Judiciary House of Representatives, House Report No. 952, 89th Cong., 1st Sess., p. 114.

[10]Report of the Special Subcommittee on State Taxation of Interstate Commerce of the Committee on the Judiciary House of Representatives, 88th Cong., 2nd Sess., HR 1480 (1964), pp. 197-232.

In an Indiana survey,[11] in answer to the question, "Does your State (ever) include dividends in the apportionment base?" 31 states answered "yes."

This Court in *Curry v. McCanless*, 307 U.S. 357 (1939), rejected the situs test for a determination of the power of a state to tax intangibles under the due process clause. It there simply noted that more than one state could give benefits and privileges concerning intangibles which gave rise to taxing jurisdiction.

It is therefore respectfully submitted that there is no shown threat of double taxation of constitutional infirmities in including all of Appellant's unitary income, including income from intangibles, in income subject to apportionment in part to Montana.

C. A DETERMINATION OF APPELLANT'S MONTANA INCOME TAX LIABILITY BY "COMBINING" THE INCOME AND APPORTIONMENT FACTORS OF APPELLANT AND SIX SUBSIDIARY CORPORATIONS WHICH CONDUCTED A UNITARY BUSINESS WITH APPELLANT DOES NOT RAISE A SUBSTANTIAL FEDERAL QUESTION OR DENY THE APPELLANT ANY CONSTITUTIONAL RIGHTS.

The only question in regard to "combined reporting" is whether or not tax consequences should be different if a unitary trade or business is carried on under one cor-

[11]The State of Indiana conducted a survey to determine state progress towards uniformity. It published the results in a report entitled, "Results of a Survey of the Uniformity of State Tax Laws by the State of Indiana," (dated February 15, 1977 and reproduced in full as Supplemental A to the Appellee's Brief in *U. S. Steel Corp., et al. v. Multistate Tax Commission, et al.*, S. Ct. Docket No. 76-635.)

porate umbrella or several corporate umbrellas. If Corporation A manufactures a product which it sells to a sales subsidiary Corporation B and Corporations A and B are so interrelated in their business affairs that the separate profits of Corporation A cannot be determined apart from Corporation B and vice versa, it is perfectly logical and necessary to combine Corporations A and B to determine the true income of either Corporation A or B. This is the sum and substance of combined reporting. It is simply an accounting device to determine the true apportionable income of any member of an affiliated group conducting a unitary enterprise with other members of an affiliated group. For example, in *Bass, Ratcliff & Gretton v. State Tax Commission*, 266 U.S. 271 (1924), this Court permitted apportionment between a corporation manufacturing ale in England and selling it in New York. Under the combined report method, it would make no difference in computing the New York tax attributable to New York sales activity if such activity were carried on by a sales subsidiary in New York or directly by the parent. Thus, the only question posed by "combined reporting" is whether the corporate shell game or business and economic reality should control tax consequences. Stated otherwise, should form control over substance? Under "combined reporting," substance and not form controls.

The Supreme Court of California, in upholding "combined reporting" did so because it could not justify a different result in *Edison-California Stores v. McColgan*, 30 Cal.2d 472, 183 P.2d 16 (1947) from the result it arrived at in *Butler Bros. v. McColgan*, 17 Cal.2d 664, 111 P.2d 334, aff'd 315 U.S. 501 (1942), simply because in the *Edison Stores* case the business activity was carried on by a parent and subsidiary corporations and

in *Butler Bros.* is was carried on through divisions of the same corporation.[12]

The unitary concept within the "combined reporting" context is directed to the same problem that was before this Court in *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113 (1920) wherein this Court noted:

> "The profits of the corporation were largely earned by a series of transactions beginning with manufacturing in Connecticut and ending with sales in another state. . . . The legislature, in attempting to put upon this business its fair share of the burden of taxation, was faced with the impossibility of allocating specifically the profits earned by the processes conducted within its borders." (254 U.S. 120, 121)

In the *Underwood Typewriter Co.* case, would the result have been different if a parent corporation had conducted the manufacturing operation in Connecticut and a sales subsidiary had conducted the sales activities in another state? We think not.

The need for "combined reporting" can be illustrated by an actual example of a multinational corporation conducting unitary operations in Canada and Idaho through two subsidiary corporations. The Canadian subsidiary processes pulp used for the manufacture of paper by the American subsidiary. The pulp is transported from the Canadian subsidiary to the American subsidiary by a pipeline crossing international boundaries. Under these circumstances, it is impossible to separate the profits of the Canadian subsidiary from

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[12]Furthermore, in the application of the unitary concept to a group of corporations ("combined reporting"), it makes no difference whether the affiliated group of corporations includes some foreign corporations or wholly domestic corporations.

that of the American subsidiary because the profits of the two corporations from the manufacture of pulp and paper products were earned by a series of transactions beginning in Canada and ending in sales. Thus, logic dictates that "combined reporting" be utilized to determine the profits of either of these two subsidiaries.

It is interesting to note that, though C.O.S.T. argues that "combined reporting" is unconstitutional, it admits that "If the amount of in-state income depends on accounting hypotheses or on an assumed division of income between branches of an integrated business, this Court justifiably refrained from intervening on the side of the corporate taxpayer simply because its calculation of instate income varies from that of the taxing authorities." (C.O.S.T. Br., p. 18). Yet, by arguing that "separate accounting" between members of a group of affiliated corporations, conducting a unitary business, should control tax consequences, C.O.S.T. is really asking this Court to intervene on the side of corporations based upon accounting hypotheses or an assumed division of income between branches of an integrated business simply because these branches are separately incorporated.

The constitutionality of "combined reporting" is supported by the decisions of this Court permitting the apportionment of the unitary income of a unitary business and the early utility property tax cases.

In the utility property tax cases it made no difference in applying the unit rule of valuation whether the utility system was owned and operated by a group of affiliated corporations or by a single corporation. In *Cleveland et al. Railway Co. v. Backus*, 154 U.S. 439 (1893), the Court rejected separate accounting for that part of a railway system which was located in the taxing state.

Apparently, several separate corporations were involved but were a part of a single system of operation. No question was raised that the separate corporate entities should be assessed separately.

In *Southern Railway Co. v. Kentucky*, 274 U.S. 76 (1927), as indicated by the dissenting opinion therein and by *Commonwealth v. Southern Railway Co.*, 193 Ky. 474, 273 S.W. 11 (1921), and *Southern Railway Co. v. Commonwealth*, 204 Ky. 388, 264 S.W. 840 (1924), this Court had before it the question of the valuation of the franchise of a railroad system where the instate railroad was owned by an out-of-state parent that operated the system. The sole question at issue was whether or not Kentucky had reasonably apportioned to Kentucky the franchise value attributable to the parent as a result of the subsidiary's presence in Kentucky. This Court assumed that the apportionment of a part of the parent's franchise value to Kentucky was proper since the out-of-state parent and the Kentucky subsidiary were part of a unitary utility system.[13]

In *Commonwealth v. Southern Railway Co., supra*, the Court simply held that the parent was present in Kentucky since the subsidiary was operated as its agent and therefore Kentucky could tax a reasonable proportion of the parent's franchise value.

Contrary to Appellant's and C.O.S.T.'s argument, a "combined report" does not subject to taxation a combined member of an affiliated group which is not conducting business in deriving income from the taxing state. "Combined reporting" is nothing more nor less

[13]It relied on *Southern Pacific Terminal Co. v. Commerce Commission, et al.*, 219 U.S. 498 (1911), and *Chicago-Milwaukee & St. Paul Railway Co. v. Minneapolis Civic and Commerce Assoc.*, 247 U.S. 490 (1918), in support of its decision.

than an accounting method to determine the true income and proper apportionment of the corporation subject to tax. For example, if Corporation A conducts a unitary business with its subsidiary Corporation B, to determine the income tax liability of either Corporation A or B, if their operations are integrated and unitary, these corporations are treated as conducting a single business and are taxed accordingly. Thus, after eliminating transactions between Corporations A and B, their combined income and combined apportionment factors are used to determine the income tax liability of either Corporation A or B. If Corporation A is present in the taxing state and Corporation B is not, Corporation A would be the sole taxpayer. No effort is made in any way to subject Corporation B to tax. If the combined income of Corporations A and B is $100,000 and ten (10%) percent of the combined activities of Corporations A and B are in the state as the result of Corporation A's activities there, Corporation A would be liable to the taxing state on ten percent of the combined income or $10,000. Corporation B would not be subject to tax in any manner whatsoever.

It is therefore respectfully submitted that the "combined reporting" issue, which the Courts have construed as an application of the unit or unitary rule of taxation, does not raise a substantial federal question.

D. AN EXAMINATION OF THE OPINION OF THE SUPREME COURT OF MONTANA INDICATES THAT THIS APPEAL INVOLVES ONLY AN INTERPRETATION AND APPLICATION OF SECTIONS 84-1503 AND 84-1508 R.C.M. 1947 PERTAINING TO THE AUTHORITY OF THE APPELLEE TO APPORTION THE UNITARY INCOME OF THE APPELLANT FOR MONTANA CORPORATE FRANCHISE TAX PURPOSES.

Notwithstanding the arguments of Appellant and C.O.S.T. to the contrary, the only justiciable issues decided by the Supreme Court of Montana are (1) the authority of Appellee to adopt the Montana regulations 1001-1020 (Chapter 10) employing the unitary concept and the UDITPA distinction between "business" and "nonbusiness" income for the division of income; (2) what income of Appellant was properly classified as "business" income from its unitary operations; (3) whether the Montana statute permitted Appellant's income to be determined by "combined reporting"; and (4) whether the Appellee and six of its wholly owned subsidiary corporations were conducting a unitary business for "combined reporting" purposes.[14]

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[14]As heretofore indicated, since "combined reporting" to Montana actually reduced the Appellant's Montana income tax liability for the years in question, it is questionable whether the Appellant had standing to object to the "combined reporting" method of determining its income tax liability. Certainly, in order to have standing to raise the "combined reporting" issue as a constitutional issue, the Appellant must show actual harm to it by the Appellee's use of "combined reporting" to determine Appellant's Montana taxable income. Appellant attempts to circumvent the application of this rule by asserting that "combined reporting" increased its tax liability for two years and failed to indicate that the decreased tax liability for the other years involved in the audit more than offset any such increase (Jurs. St., p. 18, footnote 6).

In resolving these questions, the Supreme Court of Montana held (1) that the regulations which adopted the language of UDITPA were a proper interpretation and application of Section 84-1503 R.C.M. 1947; (2) that all of the Appellant's income was "business" income subject to apportionment; (3) that Section 84-1503 R.C.M. 1947 permitted the Appellee to determine the Appellant's income tax liability to Montana by the "combined reporting" method of accounting; and, (4) that Appellant and its six combined subsidiary corporations were conducting a unitary business.

In resolving the business income issue, the Court stated as follows:

> "The regulations are clear and simple. All business income is apportionable and nonbusiness income is allocated to source. ASARCO argues that certain items of income listed above are nonbusiness income and therefore properly deductible from apportionable net income. This contention is incorrect.
>
> "The regulations state that business income includes income derived from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operation. After an in-depth examination of the income in question, we find this income is derived from sources that are integral portions of its business. This finding is in direct conflict with the district court's finding of fact which state this income is nonbusiness income. The test of whether this income is in reality business or nonbusiness income is a matter of statutory interpretation. We feel therefore that the finding of the district court is in error. We are confronted herein with a conclusion of law, rather than a finding of fact. Listed below are examples of

the relationship of this alleged nonbusiness income to ASARCO." Appellant's Appendix pp. 10a-11a.

The Court then found as a matter of fact that all of the income of ASARCO was associated with its trade or business operations and constituted an integral part thereof and therefore was properly classified as business income and subject to apportionment.

In regard to the "combined reporting" issue, after reviewing some of the facts pertaining to the relationship of Appellant's activities to the six wholly owned subsidiary corporations combined with Appellant, the Montana Supreme Court held that the business operations of the Appellant and its six combined subsidiary corporations was unitary. In arriving at this conclusion, it relied upon the Oregon Supreme Court decisions in *Coca-Cola Co. v. Department of Revenue*, 271 Or. 517, 533 P.2d 788 (1975), and *Zale-Salem, Inc. v. Tax Commission*, 237 Or. 261, 391 P.2d 601 (1964).

An examination of the briefs and arguments in this cause and the opinion of the Montana Supreme Court reveals that this case does not involve any question concerning the validity of the Multistate Tax Compact, the Commission's joint audit program or the advisory rules and regulations of the Commission. Furthermore, no constitutional issues, except by application for rehearing, were ever raised in the appellate proceedings below. Thus, these issues are not properly before this Court and are apparently raised here by Appellant and C.O.S.T. to divert attention from the real and limited issues here involved which in no way raise any substantial federal question.

Many of the arguments of C.O.S.T. in their amicus brief are merely a rehash of some of the arguments presented by the Appellants in the *U. S. Steel et al. v. Multi-*

state Tax Commission, et al., case, *supra*, now pending before this Court. The Appellees' brief in that cause places such arguments in their proper perspective.[15]

There is absolutely nothing in the record in this cause to indicate that the Commission's regulations pertaining to Article IV of the Compact (UDITPA) were involved. No brief of either party nor none of the decisions of the lower tribunals mentioned anything concerning the Compact or the Commission except for recital of the fact that the Commission audited the Appellant's books and records on behalf of the state of Montana and other states. In conducting such audit, the Commission was bound to follow the rules and regulations and the laws of Montana and the specific guidelines and instructions furnished the Commission auditors by the Appellee. Furthermore, the joint audit of Appellant's books and records on behalf of Montana and other states was conducted with the consent of Appellant and did not in any

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[15]In fact, as indicated in Appellant's brief in opposition to the Commission's request to file an amicus brief in the Montana Supreme Court, the Appellant asserted:

> "It is true that the audit which formed this basis of this litigation was conducted by the Multi-State Tax Commission. *But this act has no bearing whatsoever on the issue on appeal herein.* There never was any question in this case as to the audit information. Thus, the issue on appeal does not relate to the validity of the mechanics of the audit. Rather, the issue on the Department's appeal concerns the time at which the principals of UDITPA became effective in Montana. This issue, ASARCO submits, is solely and exclusively one of Montana law, in which the Multi-State Tax Commission has not one bit of interest with respect to which there is no need whatsoever to 'uniform interpretation and application by the member states' of the Multi-State Tax Commission." (Emphasis supplied; 80a-81a)

We submit that this is a correct statement except that the Montana Regulations involved an interpretation of Section 1(a) of UDITPA.

way involve the exercise of any subpoena or other authority on behalf of the Commission. Thus, C.O.S.T.'s and Appellant's effort to treat this appeal as one involving the validity of the Compact, the Commission, its joint audit program or its advisory rules and regulations is totally unwarranted and completely unsupported by the record.

IV.

CONCLUSION

The Montana Supreme Court had before it for resolution only state law questions. It did not have before it for consideration any questions concerning the Compact, its Commission or its joint audit program. It did not have before it for consideration any contention that the classification of all of Appellant's income as apportionable business income transgressed any constitutional limitations. Neither did it have before it any contention that "combined reporting" was unconstitutional. The only issues before the Montana Supreme Court were the interpretation of Montana law, the application of the language of UDITPA as a regulation and "combined reporting" for a determination of the Appellant's properly apportionable income to Montana. Furthermore, inasmuch as there is no question but what the well-recognized three factor apportionment formula is constitutional in apportioning all of the unitary income of a unitary business, whether conducted in a single or a multiple corporate form, it is crystal clear that there could not possibly be any substantial federal question raised in this cause. For, if anything is settled by the decisions of this Court, it is that unitary income of a trade or business can be apportioned by the well-recognized three factor UDITPA apportionment formula.

This is particularly true when a taxpayer, which is the case at bar, has failed to establish by "clear and cogent evidence" that the application of an apportionment formula results in the taxation of extraterritorial values. The fact, relied upon by Appellant (Juris St., p. 14), that Appellant's income tax liability was increased elevenfold by apportionment of its unitary income by the UDITPA three-factor formula does not establish that the formula arrived at an unreasonable result. It simply demonstrates the invalidity of Appellant's "hybrid" method of reporting its income tax liability to Montana for the years in question.

It is therefore respectfully submitted that this Court dismiss the appeal.

Respectfully submitted,

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